IMIA

ESG Sub committee

Environment – Social – Governance

ESG: A guide for Construction & Engineering Underwriters

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INTRODUCTION

In the years after the turn of the millennium, organizations around the world are becoming aware of the need for, and benefits of, socially responsible behaviour. In 2010 the voluntary standard ISO 26'000 was edited to guide and support any Organization to contribute to sustainable development. Five years later the United Nations established the Sustainability Development Goals (SDG), wherein 17 different areas are described to contribute to a more sustainable, healthier, safer and more resilient society. These SDGs were transferred into three main groups of sustainability issues, related to environmental, social and governance aspects, the so-called ESG framework.

Investors, shareholders and also re-insurers are increasingly considering ESG criteria and associated ratings in their decision-making processes.

As a consequence, the reporting obligations for almost all companies of any size worldwide will be enhanced with such non-financial ESG ratings. Although the definition of globally acknowledged measurement and rating criteria remains difficult, ESG ratings have already had an impact on companies' reputation as well as on customers' and investors' engagements. This is set to become even more important in the future.

The above reporting requirements also impact the insurance industry to become more ESG compliant and support its role in developing a more sustainable society.

What does that actually mean now for Construction & Engineering Underwriters?

Guidance specific to Construction and Engineering Underwriting doesn't exist as we publish this paper, as this line of business has not been part of PCAF and ex-NZIA guidance documents.

IMIA Working Group paper n°89 first elaborated on those topics in 2014 (see IMIA website)

in September 2022 an IMIA ESG Subcommittee has been set up with following objectives:

- Enhance Underwriters awareness on ESG aspects including what ESG means and how it applies to our industry and clients in the construction process.
- Give guidance to Underwriters on how to address those issues from Underwriting stage, during the course of construction and potentially during claims handling.
- As a follow-up step, propose key areas for an ESG risk assessment including ESG rating criteria.

This paper is part of a series of papers issued by the Subcommittee: See ESG PWG Website in IMIA.com

1 MAIN GOALS OF THE ESG GUIDE FOR UNDERWRITERS

Guide the UWs on what ESG means for their day-to-day work.

Adapt existing ESG standards to what is relevant for Construction & Engineering

Present the ESG aspects on the whole life of a construction project, from first feasibility study up to dismantling.

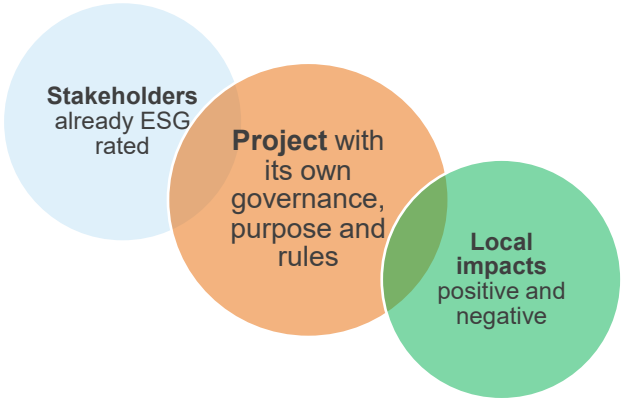
Provide practical guidance to underwriters in the identification of ESG aspects that are material to their business, at UW stage, during survey on site, and when assessing claims.

2 THE SPECIFICITIES OF A CONSTRUCTION PROJECT

2.1 A Project is a small organization in itself

Any type of “something being built” has its own, project specific organization, with a start - and finish date, its own governance, decision-making processes, rules, norms and guidelines. All that is based on the valid standards and regulation of the respective country, where the project is located and implemented by the various stakeholders who are involved in the project.

As a consequence, a project specific ESG assessment includes the analysis of the stakeholders’ ESG practices and ratings as well as the analysis of the location based, country specific ESG framework (such as local regulations, local constraints), the project occupancy (purpose, benefits, long term impact), and the geographical footprint itself.



2.2 Stakeholders have an influence at each stage of the project

The following graph is showing all stages and representing main stakeholders and their influence at each stage and component of a typical project lifespan.

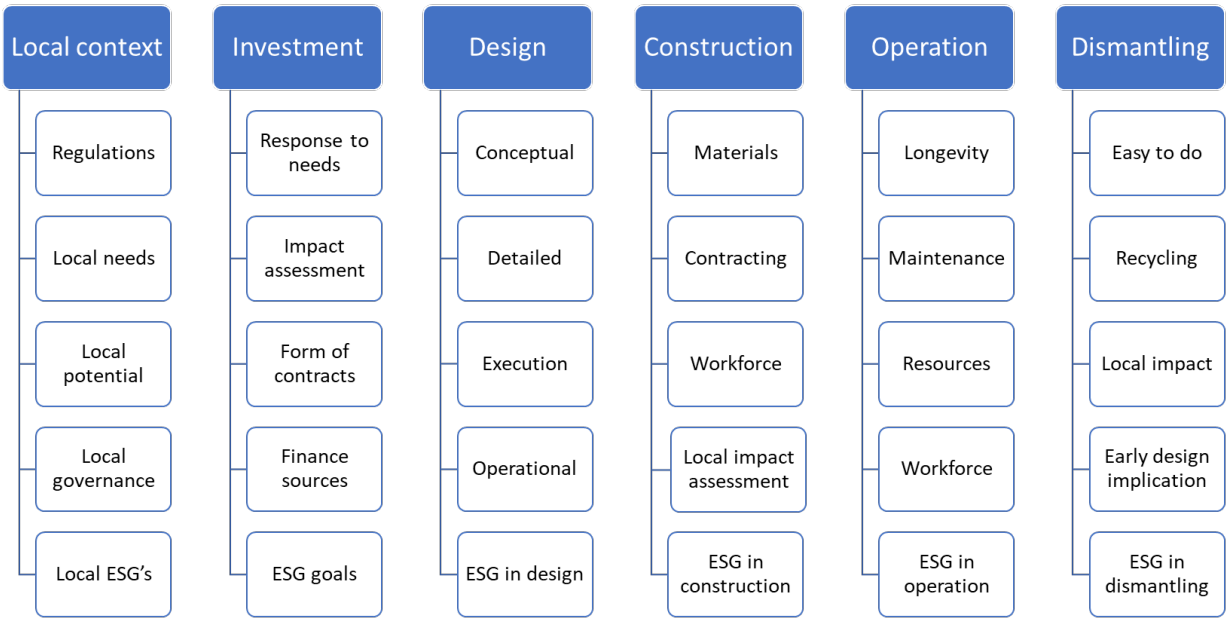
Expectations and effectiveness of the project specific ESG framework and goals are defined and enforced by the **Project owner** and the **Investors**, taking into account the legal requirements, the **Consumers or Users** expectations, the requirements of finance institutions and government initiatives. Thus, owners and investors (as they have to pay the bill at the end), will have by far the highest influence and impact on project specific ESG aspects. ESG criteria are more and more used in the selection process for designers, contractors and suppliers.

Subsequently the **Architects and Designers** will implement these ESG requirements into their project design, e.g. defining the structure, the use of “green” or recycling materials, the building shell, building technology etc.

During construction, **Contractors and Suppliers** are obliged to comply with the ESG practices defined and implemented by the owners as well as the design requirements by the designers. Complying with or even exceeding ESG requirements, defined by the owner, should result in an advantage during the tender phase for contractors or suppliers.

Once a project is completed, **Operators and Users** are responsible for the consumption of resources (energy, water) as well as workforce deployment with associated labor practices.

Last but not least, at the end of lifespan, **dismantling** will take place. The environmental impact of this phase is also depending on forward-looking decisions taken already during the design phase of a project. These decisions shall enable easy dismantling processes and make sure that **recycling and/or the reuse** of machinery and materials for other purposes are possible.



3 OVERVIEW AND KEY RESOURCES

3.1 Do not hesitate to use your common sense first

Several topics, as listed below in no order of importance, are quite common in the insurance industry and could give you a first go-no-go idea. They may already appear in your current Underwriting guidelines.

Environment:

- UNESCO protected sites / Arctic sites.
- Coal phase out
- Science based targets initiative to validate Net Zero targets.
- Specific focus on Dams
- Ancient woodlands

On Social aspects:

- FPIC: Free Prior and Informed Consent
- Child labor / Forced Labor / Human traffic.
- Tobacco industry
- Military industry

Governance:

- Corruption

Controversies and different opinions: Beside company websites of involved stakeholders, check also external, independent third-party websites, comments and papers, highlighting potential controversies, and respond to the following question:

"Do I want my insurance company's name on that project?"

3.2 Good sources of standards and metrics

3.2.1 United Nations 2015: Sustainability Development Goals

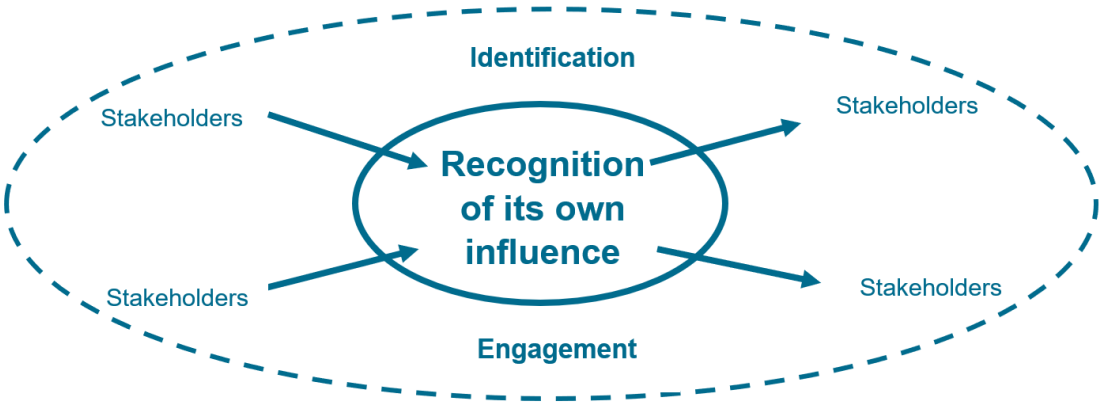
We should look first to the 17 Goals for sustainable development published by the United Nations:

THE 17 GOALS | Sustainable Development (un.org)

The two sources that we have found easy access to, and most relevance to our industry for developing this guide are: ISO 26000 and PSI ESG

3.2.2 ISO 26000

A Guidance for Social responsibility – issued in 2010 - recognizing the influence of any company and organization on its environment: ISO - ISO 26000 — Social responsibility



And setting the 7 core subjects of Social Responsibility being all interdependent:

1. Organizational governance
2. Human rights
3. Labour practices
4. The environment
5. Fair operating practices
6. Consumer issues
7. Community involvement and development

3.2.3 PSI ESG guide for Non-Life Insurance Version 1.0 issued in 2012

www.unepfi.org/psi

> "The Principles for Sustainable Insurance provide a global roadmap to develop and expand the innovative risk management and insurance solutions that we need to promote renewable energy, clean water, food security, sustainable cities and disaster-resilient communities."
>
> UN Secretary-General (June 2012)

They encourage insurance companies to develop their own metrics and reporting systems with 4 principles:

Principle 1: We will embed in our decision-making environmental, social and governance issues relevant to our insurance business

Principle 2: We will work together with our clients and business partners to raise awareness of environmental, social and governance issues, manage risk and develop solutions

Principle 3: We will work together with governments, regulators and other key stakeholders to promote widespread action across society on environmental, social and governance issues.

Principle 4: We will demonstrate accountability and transparency in regularly disclosing publicly our progress in implementing the Principles

They develop this by listing criteria and themes with an 'economic sector and insurance product heat map'. We list the topics here, they are more detailed in the paper itself:

Environment	Climate change
	Environmental degradation
	Protected sites/species
	Unsustainable practices
	Animal welfare/testing
Social	Human rights
	Controversial weapons
Governance	Bribery and corruption
	Poor corporate governance
	Poor product safety and quality

Other relevant voluntary international standards being developed more recently are:

3.2.4 World Economic Forum –

Common metrics on Sustainable Value Creation – issued in September 2020:
Explore the Metrics > Measuring Stakeholder Capitalism | World Economic Forum (weforum.org) and
A white paper issued in September 2020
WEF_IBC_Measuring_Stakeholder_Capitalism_Report_2020.pdf (weforum.org)

A report from KPMG on how to use them, published in 2022.
Measuring Stakeholder Capitalism WEF IBC common metrics (kpmg.com)

3.2.5 IFRS ISSB, The International Sustainability Standards Board of the IFRS Foundation

Backed by the G7, G20, the International Organization of Securities Commissions (IOSCO), the Financial Stability Board, African Finance Ministers and Finance Ministers and Central Bank Governors from more than 40 jurisdictions.- is currently developing reporting standards for sustainability disclosures.

In June 2023 they issued 2 first IFRS ® reporting standards:

- IFRS S1: General requirements for Disclosure of Sustainability-related Financial information - IFRS - IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information
- IFRS S2: Climate related disclosures - IFRS - IFRS S2 Climate-related Disclosures

In addition, the SASB (Sustainability Accounting Standard Boards) developed 77 different sustainability standards for most industries within 11 main industry sectors
(Based on the Sustainable Industry Classification System® Find your industry - SASB).

The industry "**Engineering & Construction Services**" has four major segments: engineering services, infrastructure construction, non-residential building construction, and building subcontractors and construction-related professional services. It is part of the **Infrastructure** industry sector**.** Note, that Home Builders (residential buildings) are another sub-sector of Infrastructure and has its own Sustainability Accounting Standard

- Sustainability Accounting Standard for Construction & Engineering and for Insurance services: Download SASB Standards - SASB) very recently published in June 2023.

We also keep in mind that a lot of local and international, sustainability disclosure requirements are now being introduced in many countries, impacting any industry and improving data transparency and non-financial reporting. To name a few:

Europe: European Commission Financial Directive, Corporate Sustainability Reporting Directive, EU taxonomy,

North America: US Securities and Exchange commission guidance regarding Disclosure related to Climate Change….

4 DETAILED SCREENING TOPICS

Based on the above-mentioned standards and documents, the following topics are important for Construction and Engineering Insurers to conduct comprehensive ESG assessments for single construction projects. Such ESG assessments will form an important part of any underwriting quotation process and risk engineering on-site assessments during construction process.

As mentioned above, the assessment should not only include impact and emissions during the construction process. The entire lifecycle impact of buildings and infrastructure, such as the consumption of energy and water during operation has to be considered in the assessment and last but not least the dismantling. The phase-out of fossil fuels will require the dismantling, recycling and disposal including associated cleaning works of infrastructure, plants, refineries etc. of an almost unimaginable scale.

It is probably not possible to check all topics in detail, due to lack of required information, time constraints and the like, the Underwriter and/or Risk Engineer has to prioritize and select the most relevant.

Note that for other Lines of businesses, such as General Liability or Workers Compensation, additional and other topics and criteria are relevant to conduct comprehensive sustainability assessments.

4.1 Environment

Nowadays environmental discussions are mainly driven by relevant climate change issues, including the reduction of GHG emissions, decarbonization and mitigation measures against the consequences of climate risks, e.g. improving of flood protection systems. Keep in mind, that the latter often requires structural measures causing additional GHG emissions.

The pollution of air, water and soil, the integrity of protected and heritage sites, the protection of endangered plants and species as well as substantial improvements on recycling and circular economy are further environmental topics to be considered.

4.1.1 Climate Change

GHG emissions

- Measurement, monitoring and reporting of GHG emissions
- Ongoing maximisation of GHG emissions reduction
- Ongoing efficiency improvement of GHG emissions reduction.
- Offset the remaining GHG (Carbon capture)

Transition to net zero GHG emissions

- Decarbonization plans / - Targets

Adaptation to extreme weather events (so called climate risks)

- Risk mitigation and protection against extreme weather events at the project location as well as at the production facilities of material and machinery suppliers.

4.1.2 Environmental pollution and degradation (outside GHG emissions)

Air

- Particulate matter
  Other air polluting gases

Soil

- Greenfield vs brownfield
- Soil pollution
- Waste sent to landfill
- Unconventional mining practices (mountain top removal, deep sea mining etc.)

Water

- Water pollution
- Reduction of water consumption
- Wastewater treatment

Noise

- Noise measurement and monitoring
- Noise reduction and protection

4.1.3 Biodiversity

- Preservation of United Nations protected and heritage sites,
- Limitation and compensation of Deforestation.
- Protection of endangered plants and species,
- Limitation and compensation of any other biodiversity impacts

4.1.4 Circular economy

- Material Recycling from demolition, concrete aggregates, wood, bricks, steel.
- Reuse of water
- Waste management

4.2 Social

Social aspects include the Health & Safety culture on a construction site as well as during operation and the impact on local communities. This can include negative aspects, such as the resettlement of local populations or positive aspects, such as improvement of the local infrastructure.

4.2.1 Labor Practice

- Work-related Health and Safety Records
- Violation of worker's rights (e.g. discrimination)
- Development and training for workforces

4.2.2 Community involvement and development

- Forced resettlement of locals – land acquisition, purchase, compensation
- Involvement of the local communities as workforce during construction and operation and dismantling.
- Infrastructure improvements for the local communities (e.g. new roads, energy supply, health facilities)

4.3 Governance

Main governance aspects include risks associated with bribery, corruption and anti-competitive practices, such as conflicts of interest, price fixing, antitrust behaviour, relevant management systems, protecting and maintaining business ethical standards. Are employee awareness and training programs related to anti-corruption, internal reporting systems for suspected violations etc. in place?

Governance should also assure that ESG topics are permanently assessed and improved, during the construction and the operation of a project.

4.3.1 Continuous application of ESG criteria throughout the lifecycle of a project: (Design, construction, operation, Dismantling)

- Collection and evaluation of relevant ESG data and information
- Improvement and mitigation strategies
- Reporting
- Application of ESG standards to subcontractors and suppliers.

4.3.2 Management Systems and operating practices

- Bribery and corruption: Risk identification systems, employee trainings regarding code of conduct and business ethics, Reporting and follow-up channels for violations.
- Corporate governance: Reporting, investigation enforcement as well as the implementation of disciplinary procedures related to anti-competitive practices, violation of anti-trust laws, conflict of interests, protection of confidential business information etc.
- Fair competition: Promoting social responsibility on the value chain.

5 HOW TO USE THE GUIDE

5.1 Antitrust consideration

The guide wants to fill the awareness gap on ESG aspects for construction Insurance. It offers a starting point for insurance companies who intend to develop their own guidance.

It doesn't set standards, nor guide you on risk appetite. You are free to integrate this into your risk management framework the way you want.

5.2 When to use the guide?

All Construction & Engineering projects have impacts on Environmental, Social and Governance aspects from start of the first idea to the dismantling of the last piece of concrete.

Any participants involved in the first feasibility studies, the investment, the design, construction, operation, and dismantling process are obliged to comply with the existing specifications and standards.

With large construction projects obviously having a major impact on ESG, insurers are only involved shortly before site mobilization to evaluate ESG aspects during the underwriting quotation process. Further options to evaluate and influence or even improve ESG aspects can be either part of Risk Engineering surveys during the construction period or as part of claims processing.

5.2.1 Actions during underwriting quotation process

- What are the ESG standards the project organization is working with? Can we rely on them, or do we need to apply our own system?
- What type of information is required to assess a construction project regarding ESG aspects?
- What are the criteria and measurements to rate ESG aspects? Do we rely on a qualitative system, or do we need a quantitative rating system?
- How do we handle different ratings for the three aspects, e.g. a positive E related rating vs. a negative S or G related rating?
- How do we communicate findings to our customers?
- In case of a negative rating, what do we do? Do we reduce or decline insurance coverage, increase the premium, modify terms and conditions, do we request improvements, knowing that this can take years to be implemented?

5.2.2 Actions during risk engineering site surveys?

- Are ESG aspects also assessed as part of the regular Risk Engineering site surveys?
- How are the findings reported? Can we link ESG matters to loss prevention?
- What are the consequences if ESG requirements/standards are not met?

5.2.3 Actions during claims processing

- So far no correlation is foreseeable and maybe such a correlation does not even exist. How do we investigate the influence of ESG aspects on losses? If ever we find some correlation, how can we implement learning and improvement effects?
- After destruction or damage, how are ESG aspects taken into account in the rebuilding process?

5.3 Guidance on KPIs

If your intention is to set KPIs on the above proposed topics, we would recommend using a qualitative assessment rather than quantitative. The comparison of ratings for different aspects within one of the three main groups, Environmental, Social, Governance and based on quantitative criteria's is already very difficult. For example, how can you compare greenhouse gas emissions with water management practices to reduce pollution and consumption of water?

Furthermore, to compare different ratings across the main groups seems almost impossible. How can you compare social aspects, like the employment of local labor or the benefits for the local communities with the above mentioned, environmental aspects, with the greenhouse gas emissions or water management practices?

The rating criteria to use will include words like:

- Issue - Exposed / No issue - Not exposed
- Considered / Measured / Reported.
- Not considered / Mitigated / Offset
- Non certified / Engaged in certification / certified

Or something more neutral like:

- Poor – fair – good – excellent
- Low – medium – high – very high
- N/A - not compliant -partially - fully

6 OUTLOOK - NEXT STEPS

The ESG regulations and non-financial disclosures obligation are moving fast. The IMIA ESG Sub-committee will continue watching this and report on an ad-hoc basis to continue guiding Construction & Engineering Underwriters.